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SUBJECT: IS THE COST OF LIVING INCREASING IN COLOMBIA?

REF: BOGOTA 3076

**¶1. (U) SUMMARY.** Inflation figures over the last 12 months indicate an acceleration of an already increasing cost of living in Colombia. Analysts expect the consumer price inflation to come in at double the target for 2008, and prices for producers have risen even faster. While a month-long depreciation of the peso against the dollar has given exporters and expatriates living in Colombia some breathing room, more nuanced observers worry that more expensive imported inputs will further fuel inflation. END SUMMARY.

PRICES FOR PRODUCERS OUTPACE THOSE FOR CONSUMERS

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**¶2. (SBU)** Colombia's Consumer Price Index (CPI) rose by 7.9 percent for the 12 months through August, 2008, well above the Central Bank's 3.5 - 4.5 percent inflation target for the year. While CPI growth has risen steadily, some analysts have expressed more concern recently about the growth in the Producer Price Index (PPI), which hit 9 percent for the last 12 months. In contrast, the annual growth in 2007 of the PPI reached only one percent. German Verdugo, Research Manager of Correval Brokerage House, attributed the increase in the PPI to a lag in the effect of higher commodity prices as well as the more recent weakening of the peso. Several analysts believe that businesses will soon have to pass on their higher costs to consumers.

RECENT PESO DEPRECIATION: EXPORTERS AND EXPATS CHEER...

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**¶3. (U)** Colombia has seen a significant appreciation of the peso over the last five years in nominal as well as real terms (reftel). While Colombia's exporters have made their displeasure with the strong peso well known, a less vocal group has been expatriates, who have seen their dollar-denominated salaries whither against the strengthening local currency. A Colombian domestic employee making minimum wage saw her peso-denominated salary increase by 40 percent between 2003 and 2008. An American expatriate employer of that same domestic employee saw the dollar-denominated cost of the worker's salary increase by 120 percent. Similar increases in real estate and other sectors have translated into a steep increase in the cost of living for expatriates.

**¶4. (U)** From August 5 to September 5, the peso depreciated by 12.2 percent (in nominal dollar/peso terms) to 2017.53 pesos/dollar, its weakest rate since December, 2007. Javier Diaz, President of the National Association of Foreign Trade

(Analdex) said that exporters certainly welcomed the boost to their price competitiveness, but cautioned that no one could predict whether and how long the weaker peso would last. He offered his opinion that the equilibrium exchange rate appeared closer to 2000 than the 1700 seen in June and July. Diaz noted that Colombian exporters still lack a culture of using futures contracts and other derivatives to lock in favorable rates.

...BUT WILL IT PASS THROUGH TO DOMESTIC PRICES?

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15. (SBU) While exporters and expats welcome 2000 pesos per dollar, some fear that a weaker peso will result in higher-priced imported inputs and increased inflation. Analysts estimate that the peso's depreciation already canceled out the recent fall in commodity prices and its ability to reduce inflation. Nonetheless, it remains unclear whether the higher cost of imports will pass through to domestic prices. Gonzalo Palau, Director of Post Graduate Studies at Rosario University's Economics Department, estimated the exchange rate pass-through as fairly high and predicted that a weaker peso would indeed fuel inflation. He noted that the strong peso of the last five years was a primary (and largely unrecognized) reason why inflation was not higher over that period. In Palau's view, workers have already begun to expect higher inflation, which, coupled with employers facing higher costs, sets the stage for very contentious annual minimum wage negotiations in December. The outcome of these talks (which have indirect effects on prices throughout the economy) may well determine how much

Colombians see their cost of living rise.

NICHOLS